United Nations

Committee of Experts on International Cooperation in Tax Matters

Report on the third session
(29 October-2 November 2007)

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Note

Symbols of United Nations documents are composed of capital letters combined with figures.

Summary

The present report contains the conclusions and recommendations of the third session of the Committee of Experts on International Cooperation in Tax Matters, held at the United Nations Office at Geneva from 29 October to 2 November 2007. The Committee, which was established by the Economic and Social Council by its resolution 2004/69 of 11 November 2004, consists of 25 experts appointed in their personal capacity for a four-year period. The Committee dealt with the following substantive items: (a) improper use of treaties; (b) definition of permanent establishment; (c) taxation of development projects; (d) exchange of information including the United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance; (e) revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries; (f) dispute resolution; (g) revision of Commentaries and citation of the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital in the Commentaries on the articles of the United Nations Model Double Taxation Convention between Developed and Developing Countries; (h) treatment of Islamic financial instruments; and (i) report of the Expert Group Meeting on Tax Aspects of Domestic Resource Mobilization and Doha Financing for Development Follow-up Conference issues.

On the basis of the discussion of the above-mentioned topics, the Committee also produced a set of conclusions and recommendations for consideration by the Economic and Social Council, Member States and the United Nations Secretariat.

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Chapter I
Introduction

1. Pursuant to Economic and Social Council resolution 2004/69 of 11 November 2004, the third session of the Committee of Experts on International Cooperation in Tax Matters was held in Geneva from 29 October to 2 November 2007.

2. The third session of the Committee of Experts was attended by 19 experts and 97 observers. The following members of the Committee of Experts attended the session: Moftah Jassim Al-Moftah (Qatar), Bernell L. Arrindell (Barbados), Noureddine Bensouda (Morocco), Rowena G. Bethel (Bahamas), Nahil L. Hirsh Carillo (Peru), Paolo Ciocca (Italy), Andrew Dawson (United Kingdom of Great Britain and Northern Ireland), Miguel Ferre Navarrete (Spain), Harry Msamire Kitillya (United Republic of Tanzania), Kyung Geun Lee (Republic of Korea), Tizhong Liao (China), Habiba Louati (Tunisia), Ronald Peter van der Merwe (South Africa), Dmitry V. Nikolaev (Russian Federation), Serafin U. Salvador, Jr. (Philippines), Stig Sollund (Norway), Robert Waldburger (Switzerland), Armando Lara Yaffar (Mexico) and Eduardo Zaidensztat Capnikas (Uruguay).

3. The session was also attended by observers for Argentina, Australia, Azerbaijan, the Bahamas, Barbados, Belgium, Canada, Chile, Croatia, the Czech Republic, Denmark, Germany, Greece, India, Iran (Islamic Republic of), Italy, Japan, Kuwait, Latvia, Malaysia, Mexico, Monaco, Morocco, the Netherlands, New Zealand, Norway, Oman, Pakistan, Peru, Qatar, San Marino, Saudi Arabia, Senegal, Singapore, Slovenia, Spain, Swaziland, Switzerland, Thailand, Trinidad and Tobago, Turkey, Ukraine, Uruguay and Viet Nam, as well as for the Cayman Islands (Overseas Territory of the United Kingdom of Great Britain and Northern Ireland) and the Isle of Man (Crown Dependency of the United Kingdom).

4. The session was attended by observers for the following intergovernmental organizations: the African Union, the European Commission and the Organization for Economic Cooperation and Development (OECD).

5. The session was also attended by observers for the following other entities: the International Bureau of Fiscal Documentation, the International Chamber of Commerce, the Visiting International Faculty Program and the Tax Justice Network. The following participants attended the session in their personal capacity: Jon E. Bischel, Frank L. Brunetti, Stephen R. Crow, David Davies, Bruno Gurtner, Ghislain T. J. Joseph, Woo Taik Kim, Pramod Kumar, Dries Lesage, Michael J. McIntyre, Toshio Miyatake, Francisco Alfredo Garcia Prats, Shosh Shacham and Ian Young.

6. The amended agenda and documentation for the third session was as follows:

1. Opening of the session by the Chairperson of the Committee.
2. Adoption of the agenda and organization of work (E/C.18/2007/1 and Corr.1).
3. Discussion of substantive issues related to international cooperation in tax matters:
   (a) Improper use of treaties (E/C.18/2007/CRP.2);
   (b) Definition of permanent establishment (E/C.18/2007/CRP.3 and Corr.1 and E/C.18/2007/CRP.4);

(c) Taxation of development projects (E/C.18/2007/CRP.12);

(d) Exchange of information including the United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance (E/C.18/2007/5, E/C.18/2007/10, E/C.18/2007/11, E/C.18/2007/CRP.15 and E/C.18/2007/CRP.17);

(e) Revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (E/C.18/2007/CRP.6);

(f) Dispute resolution (E/C.18/2007/CRP.7);

(g) Revision of Commentaries (E/C.18/2007/CRP.8/Rev.1) and citation of the OECD Model Tax Convention in the United Nations Model Tax Commentaries (E/C.18/2007/CRP.13);

(h) Treatment of Islamic financial instruments (E/C.18/2006/9);

(i) Report of the Expert Group Meeting on Tax Aspects of Domestic Resource Mobilization (E/C.18/2007/CRP.14) and Doha Financing for Development Follow-up Conference issues.

4. Dates and agenda for the fourth session of the Committee.

5. Adoption of the report of the Committee on its third session.

Chapter II
Organization of the session

A. Opening of the session by the Chairperson of the Committee

7. On 29 October 2007, the 1st meeting of the third session of the Committee was opened in Geneva by Armando Lara Yaffar, Vice-Chairperson of the Committee. Bernell L. Arrindell served as Rapporteur, in accordance with his election as Vice-Rapporteur at the second session.

B. Adoption of the agenda

8. After discussion, the agenda was agreed to, as proposed, by consensus, reflecting the recognition that item 3 (g) needed to be modified so as to read "Revision of Commentaries and citation of the OECD Model Tax Convention in the United Nations Model Tax Commentaries" (as discussed in E/C.18/2007/CRP.13); and that new item 3 (i), entitled "Report of the Expert Group Meeting on Tax Aspects of Domestic Resource Mobilization (E/C.18/2007/CRP.14) and Doha Financing for Development Follow-up Conference issues", needed to be added.

C. Election of the Vice-Chairperson and the Vice-Rapporteur

9. Following the resignation of Patricia A. Brown from the Committee, the Committee decided that Armando Lara Yaffar would be appointed to the vacant position of first Vice-Chairperson and that Kyung Geun Lee would become second Vice-Chairperson. The Chairperson then asked for nominations for third Vice-Chairperson and Vice-Rapporteur. Andrew Dawson was nominated and then elected as third Vice-Chairperson, by acclamation, and Rowena G. Bethel was nominated and then elected as Vice-Rapporteur, also by acclamation.

D. Consideration of the rules of procedure and other organizational issues

10. The Secretary of the Committee, Manuel F. Montes, announced the appointment of a new member: Miguel Ferre Navarrete (Spain) who was replacing José Antonio Bustos Buiza (see E/2007/9/Add.11). The resignations of Pascal Saint-Amans (France), Patricia Brown and Nobuyuki Nakamura (Japan) from the Committee were also announced by the Secretariat. On behalf of the Secretariat, the Secretary expressed his deepest gratitude for their contributions and service to the Committee. The Secretary reiterated that members of the Committee acted in a personal capacity, and were appointed by the Secretary-General, after notification had been given to the Economic and Social Council. In this connection, the Secretariat was following the normal process of selection of replacements, which would take time. The Secretariat had been unable to complete the replacement in time for the third session.

11. A special lunchtime meeting, to be held on Tuesday, 30 October 2007, from noon to 1.30 p.m., was also announced by the Secretariat. The distinguished

economist Vito Tanzi would lead off a discussion on the role of revenue mobilization in development.

12. The Secretary of the Committee noted that the General Assembly, in its resolution 61/191 of 20 December 2006, had decided that the Follow-up International Conference on Financing for Development to Review the Implementation on the Monterrey Consensus would be held in Doha, Qatar in the second half of 2008 and reiterated that the review conference should assess progress made, reaffirm goals and commitments, share best practices and lessons learned, and identify obstacles and constraints encountered, actions and initiatives to overcome them and important measures for further implementation, as well as new challenges and emerging issues. The Monterrey Consensus,[1] the outcome of the International Conference on Financing for Development, held in Monterrey, Mexico, from 18 to 22 March 2002, had called for a global partnership for development in which developing countries pledged to adopt policies to improve the mobilization of domestic resources and developed countries pledged to provide additional financing and improved access to their markets to ensure that those policies had the potential to produce the desired results, in terms of growth, macroeconomic stability and poverty reduction. The Secretary noted that:

(a) The Committee should be conscious of its importance and role and the increased attention that it was receiving from States Members of the United Nations, which were particularly aware of its role as the only truly universal forum for work on tax matters;

(b) There had been incredible growth in the participation in the Committee compared with five years before. The challenge to the Committee was to respond to the growing interest and to expand its view and its activities so as to fully meet its mandate. The report of the Secretary-General entitled "Follow-up to and implementation of the outcome of the International Conference on Financing for Development" (A/62/217) of 10 August 2007 had recommended that, in line with the existing broad mandate for enhancing international cooperation in tax matters, including with development objectives in mind, the United Nations should broaden and intensify its tax cooperation work and play a greater practical role in dealing with tax matters, including emerging issues that were not currently addressed in other organizations; noted that, under the aegis of the follow-up process on financing for development, it would thus seem pertinent to undertake discussions exploring the potential for expanding tax cooperation activities at the multilateral level, including its institutional dimensions; and observed that, in particular, working with other agencies active in the field, while retaining its strong developmental focus, the Committee itself could seek to enhance greater international cooperation in ongoing areas such as combating tax evasion, taxation of services and natural resource use, and tax administration;

(c) The so-called leading group of countries on innovative sources of financing (Brazil, Chile, France, Norway and Spain) had identified capital flight and tax evasion as key issues and had expressed encouragement for increased work by different parties in this area;

[1] *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7) chap. I, resolution 1, annex.

(d) The Committee had the power to set its own agenda and define its ambitions in respect of what the Committee should achieve, which could go beyond the activities related to the United Nations Model Double Taxation Convention between Developed and Developing Countries, important as they were. The Committee was fully capable of inputting its suggestions to the Doha review conference with regard to issues that it perceived as important in the area of international tax cooperation, including, but not solely limited to, the completion of the revised Model Taxation Convention;

(e) Among the possibilities that the Committee might want to consider (and these were purely examples among many others) were recommendations to upgrade the activities and capabilities of the Committee, such as increasing the size and expertise of the permanent technical secretariat, increasing the number of members in the Committee as presently structured, and upgrading the Committee to the status of a truly intergovernmental body.

13. The Secretary presented the report of the Expert Group Meeting on Tax Aspects of Domestic Resource Mobilization, held in Rome on 4 and 5 September 2007. The Meeting, which had included the participation of several members of the Committee and other experts in the field, was convened to discuss the broader agenda of domestic resource mobilization and its role in development.

14. On behalf of the Secretariat, the Secretary emphasized that the Secretariat was prepared to provide assistance to the activities of the Committee and was looking forward to a productive session.

15. The Deputy Secretary of the Committee, Michael Lennard, then briefed on the outcome of discussions on the draft resolution entitled "Committee of Experts on International Cooperation in Tax Matters", which had been introduced at the resumed 2007 substantive session of the Economic and Social Council (under agenda item 13 (h)). He recalled that the Committee, in its report on its second session, had called for further funding for limited subcommittee and working group meetings and technical cooperation assistance aimed at capacity-building. He noted especially the offers by Viet Nam and Pakistan to host regional training workshops and the continuing lack of contributions to the United Nations trust fund. He noted that there had been difficult lengthy informal negotiations in the Council on the draft resolution, which ultimately, as adopted, did not propose additional funding but did request the Secretary-General to prepare a comprehensive report addressing the financing of the Committee's work, including that of its subcommittees, taking into account the issues raised by the Committee at its second session, for consideration by the Council at its organizational session for 2008 (see Council resolution 2007/39 of 4 October 2007, para. 3).

16. The Deputy Secretary also took note of the Expert Group Meeting on Tax Aspects of Domestic Resource Mobilization, held in Rome on 4 and 5 September 2007. He noted that the Meeting had brought together a group of Committee members and others with special expertise to consider some of the tax and development issues relating to the Monterrey Consensus and the Doha Financing for Development Follow-up Conference. He noted that it was up to the Committee to determine whether to consider the recommendations of the Group or to reject the report. The report was to be considered under new agenda item 3 (i).

17. An agreement was reached by the Committee to settle by e-mail, pursuant to a note by the Secretariat, the issue of modalities for finalizing matters by an e-mail procedure in future.

18. It was further agreed that, for the next annual session, the matter of the daily proceedings would be settled by the Committee in its closed session, but that observers could present their comments to the Secretariat for consideration by the Committee in finalizing the report.

19. It was decided that the task force on the Revision of Commentaries would be upgraded and renamed as the working group on General Issues in the Review of Commentaries.

Chapter III

Discussion on substantive issues related to international cooperation in tax matters

A. Improper use of treaties

20. Kyung Geun Lee, coordinator of the subcommittee on Improper Use of Treaties, summarized its work as discussed in document E/C.18/2007/CRP.2, indicating that the subcommittee had focused on directly translating its work into proposed new Commentary for the next version of the *United Nations Model Double Taxation Convention between Developed and Developing Countries*.[2]

21. Mr. Lee and Jacques Sasseville introduced the paper and then explained its conclusions in more detail. It was explained that, in respect of using the term "improper use of treaties" as decided at the second session of the Committee, the intention was to suggest not that every such "use" was illegal under domestic law, but rather that the use could be regarded as improper when considered in terms of the objects and purposes of such tax treaties.

22. In relation to the first sentence of paragraph 15 of the paper, it was decided that the word "clearly" would be deleted and replaced by the word "generally", with that word then removed from the latter part of the sentence.

23. There was a request that paragraph 33 be clarified so as to note that, although specific anti-avoidance rules would not represent a comprehensive solution to treaty abuse, they could form an important part of the approach.

24. The subcommittee was requested to carry out further work on the issue of beneficial ownership and it was noted this could include consideration of whether or not the concept of beneficial ownership could apply with respect to other articles of the Model Double Taxation Convention, such as articles 13 and 21.

25. There was agreement that the reference to "developing countries" in proposed paragraph 8 of the Commentary (see para. 10 of the paper) could more relevantly be made to "countries", since many developed countries were in a similar position.

26. There was also discussion on the role of the mutual agreement procedure (MAP) in this area and it was agreed that there should be a reference to the procedure in paragraph 14 of the proposed new Commentary, with the guiding principles for its application being found in proposed paragraphs 15-19.

27. It was agreed that the list of examples of treaty abuse in proposed paragraph 31 of the Commentary was illustrative and not exhaustive and that the paragraph would be amended accordingly.

28. The point was also made that the "force of attraction" principle could be modified in a bilateral treaty so as to operate only in avoidance cases. Wording to this effect could be added to proposed paragraph 31.

29. In relation to the possible general anti-avoidance rule discussed in paragraph 36 of the paper, which looked at, in deciding whether treaty benefits should be denied, whether "a main purpose" for entering into transactions or

[2] United Nations publication, Sales No. E.01.XVI.2.

arrangements had been to obtain the tax treaty benefits, there was considerable discussion on whether the wording of the test should entail "a main purpose", "the main purpose", "a principal purpose" or some other formulation reflecting matters such as the objective significance of the purpose and its relationship to possible other purposes.

30. There was a clear majority view that the proposed wording, as "a main purpose", should be adopted. Nevertheless, it was recognized that the approaches taken by particular States would often vary because of domestic legal interpretations of one formula or the other. It was agreed that the proposed Commentary would be redrafted to reflect the different approaches taken, seeking to ascertain whether a tax purpose was "the main" or "a main" purpose. It was also agreed that a corresponding adjustment to proposed paragraph 27 would be made by appropriately replacing the word "primarily".

31. It was agreed that proposed paragraph 43 of the Commentary could be elaborated to provide a more specific reference to examples used in some countries' treaty practice. It was also agreed to modify proposed paragraph 45 so as to address the question with regard to the case where the competent authorities did not reach an agreement in relation to the tie-breaker test. There was also discussion on whether there should be more consideration of actual country practice related to the provision suggested in paragraph 21.4 of the OECD Commentary as quoted in paragraph 56, including any relevant court cases, and it was decided that this would be best addressed in the proposed revised Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries.[3]

32. Proposed paragraph 56 addressed specific anti-avoidance rules including "limitation of benefits" provisions (see quoted para. 20 of the OECD Commentary on article 1). While it was recognized that such provisions had significant administrative implications and that the wording need not be altered, it was also noted that some countries regarded them as well adapted to addressing treaty abuse issues.

33. In considering the treatment of base companies (proposed para. 72), it was agreed that the first part of paragraph 10.1 of the OECD Commentary, up to the word "regimes", need not be quoted, which would entail the necessary adjustments made to paragraph 72.

34. The point was made by two countries that in citing (at proposed para. 73) paragraph 23 of the OECD Commentary on article 1 (addressing base companies through controlled foreign corporations (CFC) legislation), there must be some regard for the fact that they and other OECD countries had observations on that paragraph. It was noted that the issue of minority views had arisen in the context of permanent establishments, with note 2 of paper E/C.18/2007/CRP.3 suggesting an approach to dealing with this issue. The issue was considered by the Committee and it was decided that relevant country positions should be included in the Manual rather than in the Commentaries themselves.

35. In relation to proposed paragraphs 76-79, it was agreed to give an example of a provision limiting treaty benefits in respect of interest on back-to-back loans, based on country practice.

[3] ST/ESA/PAD/SER.E/37.

36. In the context of proposed paragraph 80, it was noted that it was not necessary, in order to conclude this work, to await developments in OECD on "hiring out of labour" issues. When the OECD work was concluded, it might become relevant to further work on the Commentaries on the United Nations Model Double Taxation Convention, for example, in relation to article 15.

37. In relation to proposed paragraphs 95-97, dealing with certain time limits for permanent establishments, it was decided that the issue was best dealt with by the subcommittee on the definition of permanent establishment, with merely a cross-reference to that work in the final version of the proposed Commentary on the improper use of treaties.

38. In connection with proposed paragraphs 98-101 of the Commentary, there was a consensus that preserving the status quo was not an option because of the possibilities for abuse. Although other possible approaches were noted, including an approach that allowed source State taxation of such gains generally — leaving it to domestic law to determine whether the treaty right to tax was exercised in a particular case — it was agreed to focus on the option of allowing source State taxation of such sales by a person where that person at any time within the previous 12 months had held the necessary percentage in the company. It was decided to "square-bracket" paragraph 101, as it involved major policy issues, and might ultimately be regarded by the Committee as being best dealt with under the Commentary to article 13.

39. It was noted that the last sentence of the paper, in referring to the recourse to arbitration, appeared to pre-empt the outcome of the consideration of agenda item 3 (f) (Dispute resolution), and that the final form of this sentence would be subject to the outcome of consideration of that item.

40. **The subcommittee was requested to substantially complete the work on the paper by the fourth session of the Committee, taking into account such issues as the application of the concept of beneficial ownership to other articles of the Model Convention and the redrafting of the Commentary to reflect different approaches taken by States to the use of the terms "the main purpose" and "a main purpose". It was agreed that the subcommittee would adopt the second option relating to gains, under the note to paragraph 101 of the paper, rather than the first option.**

B. Definition of permanent establishment

41. Stig Sollund presented two substantive papers on the definition of permanent establishment intended to finalize the work presented at the Committee's second session, the first being E/C.18/2007/CRP.3 (as supplemented by E/C.18/2007/CRP.3/Corr.1) on the proposed revised Commentary to existing article 5 of the United Nations Model Double Taxation Convention.

42. Mr. Sollund noted that the subcommittee had listed the basic differences between the permanent establishment articles in the United Nations Model Taxation Convention and those in the OECD Model Tax Convention at the beginning of its proposed redrafted Commentary to article 5, to assist those reading and working with the Commentaries.

43. It was noted that the subcommittee had proposed (at note 2) that there should be an annex to the United Nations Model Taxation Convention containing the relevant OECD member "observations" and non-OECD member "positions" on the OECD Commentaries cited in the United Nations Model Taxation Convention. The subcommittee proposed to include a note in the introduction to the United Nations Model Taxation Convention referring to the relevance of these observations and country positions. It was agreed that such an approach would be discussed when considering the issue of citation of the OECD Model. As noted at paragraph 31 above, the Committee ultimately decided that relevant country positions would be addressed in the Manual rather than in the Commentaries themselves.

44. There was a discussion on the relationship between paragraphs 1 and 2 of the article, with some support for the view that paragraph 2 was "self-standing". It was noted that while the subcommittee had been strongly of the view that paragraph 2 was not a stand-alone provision apart from paragraph 1, this view was contested by some participants.

45. The comment was made that the proposed paragraph 3 of the Commentary included the quotation of paragraphs 5.3 and 5.4 of the OECD Model Commentary. However, these were not well adapted to the United Nations Model which contained a special provision in article 5 (3) (b) dealing with services. It was agreed that the quotation of those two provisions would be retained; however, the subcommittee would include a note that they would be of less significance in the context of the United Nations Model, because of the special services provision contained in article 5 (3) (b).

46. On the relationship between paragraph 1 of the article and paragraph 3 (a) dealing with construction sites, there was discussion on whether the latter was "self-standing" or dependent on the former. It was noted that the subcommittee had taken the view that paragraph 3 (a) was not self-standing, despite the fact that it had its own time test. There was considerable discussion on these issues, and differences of views were expressed regarding the "self-standing" nature, or otherwise, of paragraph 3 (a).

47. In respect of the proposed inclusion of paragraph 19.1 of the OECD Commentary (under para. 11 of the proposed United Nations Model Commentary), it was noted that the term "twelve month" in the first line of paragraph 19.1 of the OECD Commentary should be replaced by "[six month]" for consistency with respect to the way in which paragraph 20 of the OECD Commentary had been quoted.

48. It was noted that the subcommittee proposed the deletion of the current paragraph 25 of the Commentary because it did not consider that the interpretation was supported by the article itself. Ultimately, the Committee decided that this paragraph would be retained in order to finalize the report of the subcommittee.

49. There was discussion regarding the possibility of different interpretations of article 5, placing less reliance on OECD developments. It was noted that the mandate of the subcommittee included taking into account OECD Model developments.

50. It was noted that the existing United Nations Commentary on article 5 recognized the view of some countries that a fishing vessel could constitute a permanent establishment, whereas the proposal might affect that interpretation. It

was suggested that, although the subcommittee did not consider such an interpretation to be justified by the wording of the article, some way of recognizing that interpretation under the current Commentary should be found. It was ultimately decided that the content of the paragraph would be retained in order to finalize the report of the subcommittee.

51. Mr. Sollund then considered document E/C.18/2007/CRP.4, noting that at this stage he would focus on the proposed deletion of article 14, with adjustments to ensure that situations currently dealt with by article 14 came within the operation of an amended article 5. In view of this focus, the issues relating to the treatment of fees for technical and other services were generally not discussed.

52. While there was a general recognition in discussing this paper of the difficulties in applying article 14, and a general view that the distinction between "professional services" and "business" had largely disappeared, there were also differing views on whether, with the deletion of this article, even with suggested changes to article 5 and elsewhere, the current source country taxation rights in the United Nations Model would still be retained.

53. It was agreed, however, that even if article 14 was deleted from the United Nations Model Taxation Convention, the possibility of countries' deciding to retain it would need to be recognized. Consequently, the current article and relevant Commentaries should be preserved as an annex to the Model for the benefit of those countries that wished to include this article in their tax treaties.

54. **It was agreed that the paper on an updated commentary to the existing article 5 had been finalized, taking into account the need to make a small number of minor changes to the draft, as noted in the discussions. The subcommittee was mandated to continue its work on the updating of document E/C.18/2007/CRP.4 regarding a possible new article 5 and Commentary on that article in time for consideration at the Committee's fourth session, taking into account the issues raised in the discussions.**

C. Taxation of development projects

55. Jacques Sasseville presented document E/C.18/2007/CRP.12 containing draft guidelines on the tax treatment of donor-financed projects, which had been prepared by the staff of the International Tax Dialogue Steering Group. The main issues that arose in the discussions, and the conclusions that were reached, encompassed the following:

(a) It would be made clearer that the guidelines were not intended to override the provisions of a double taxation agreement between the recipient and donor countries;

(b) It was noted that tax administrations/ministries of finance of recipient countries were often not involved in processes affecting the taxation of donor-financed projects and the importance of their early involvement was emphasized;

(c) It was agreed in relation to guideline 7 that there was a balance to be struck between accuracy in using the technical term "permanent establishment" and avoiding having to deal with what the term meant in any detail. It was agreed that

the term would be placed in quotation marks and that some clarification would be given through wording that presented a branch as a typical example;

(d) A note would be added to the guidelines indicating that care should be taken to ensure that exemption from workers' compensation and social security requirements was not included in such agreements.

56. **The staff of the International Tax Dialogue Steering Group were invited to continue their work, including discussing the draft guidelines in a joint meeting or meetings of donors and tax experts. Harry Msamire Kitillya and Habiba Louati were appointed by the Committee to liaise with the staff of the Steering Group on this issue and to monitor the work for the Committee.**

D. Exchange of information including the United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance

57. Michael McIntyre, as interim coordinator of the Exchange of Information subcommittee, presented documents E/C.18/2007/5, E/C.18/2007/10, E/C.18/2007/11 and E/C.18/2007/CRP.15. It was noted that he was presenting not a subcommittee report, but rather a paper (as interim coordinator), drawing on the comments made by some subcommittee members on an earlier one. All of the issues considered in E/C.18/2007/5 were discussed. The main issues that arose in the discussions, and the conclusions reached were as follows:

(a) The issue of the proposed "may be relevant" test in a new paragraph 1 of the current article 26 of the Model Convention was reconsidered and the respective merits of that test and the "foreseeably relevant" test were discussed. There was broad agreement that there was little or no substantial difference between the two tests, and often the preference for one or the other test came down to which test was seen as more certain in operation. A clear majority supported the "foreseeably relevant" test, especially in view of its consistency with other relevant international agreements. However, a particular preference was expressed by a few for retaining the "may be relevant" test;

(b) It was agreed that the reference to "fraud or evasion" of taxes in the same paragraph 1 should be changed to "avoidance or evasion";

(c) On the issue of reciprocity, the weight of opinion was for retaining paragraph 3 (b) as currently drafted;

(d) There was also a general agreement that the second and third sentences of paragraph 7 should be deleted. Alternatively, paragraph 7 could be replaced by the following:

"The competent authorities of the Contracting States may by mutual agreement settle the mode of application of this article";

(e) Paragraphs 4 and 5 were discussed and it was pointed out that these paragraphs were the core of the exchange-of-information provisions. There appeared to be very broad support for both paragraphs;

(f) Paragraph 6 was referred to the subcommittee for further consideration as to whether its inclusion was necessary.

58. **The Committee decided that Miguel Ferre Navarrete should join the subcommittee and assume the role of coordinator. The subcommittee was asked to continue its work with a view to coordinating the views expressed in the discussions and finalizing the work as soon as possible.**

59. Mr. McIntyre was thanked for his work as interim coordinator of the Exchange of Information subcommittee. He also presented document E/C.18/2007/CRP.17 on a Proposed United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance. He stressed the importance of the work in this area, especially in relation to the Committee's input into the Doha follow-up to the International Conference on Financing for Development.

60. **The idea of the proposed Code of Conduct on Cooperation in Combating International Tax Evasion was widely supported, although it was noted that references addressing the possible political and economic isolation of countries should be removed. It was suggested that the title of the document should be amended to refer to tax evasion only and that the relationship between normal tax planning and abusive practices should be explained. It was decided that the work should be fully integrated into the work of the subcommittee on Exchange of Information, with a view to making available a revised report and Code of Conduct as soon as possible.**

E. Revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries

61. Frank Brunetti, Jon Bischel and Stephen Crow made a presentation on the work directed towards the goal of producing a basic practical guide to tax treaty negotiations. They invited experts to provide practical examples of treaty negotiation positions to assist in achieving that goal.

62. The presenters proposed the creation of a special appendix to the Manual recording elements of discussion and information that did not easily fall within the purview of any other relevant documents such as the Commentaries, but that would assist those negotiating and administering tax treaties.

63. Various types of treaties that could be included in the Manual, as well as some of the issues involved in selecting them, were discussed. Such issues included the need to deal with treaties representing a broad spectrum of tax, general legal and economic situations and relationships involving the contracting Parties.

64. The presenters noted that they hoped to have the work completed in 2008, and to that end requested that two new members be added to the working group.

65. **It was agreed that the subcommittee would continue its work on revising the Manual. It was also decided that Renee Villagra Cayamana (observer for Peru), Salah Gueydi (observer for Qatar) and Robin Oliver (observer for New Zealand) would be added as members of the working group.**

F. Dispute resolution

66. Robert Waldburger, as coordinator of the subcommittee on Dispute Resolution, presented document E/C.18/2007/CRP.7 It was noted that he was presenting not a subcommittee report as such, but rather a paper (as coordinator). It was also noted that the offer made by OECD and the European Union (EU) to assist with the work in this area had been accepted. The main issues that arose in the discussions, and the conclusions reached, were as follows:

(a) It was widely felt that while arbitration was one option for dispute resolution, there were others that would need to be considered, and it was agreed that the further work of the subcommittee should consider other options for improving the mutual agreement procedure (MAP);

(b) There was discussion on the respective merits of voluntary and mandatory arbitration, and it was decided that both options should be considered in the subcommittee's further work.

67. **The subcommittee was asked to continue its work in light of the views expressed in the discussions, particularly in relation to ways of improving the mutual agreement procedure. It was agreed that Rowena Bethel would join the subcommittee.**

G. Revision of Commentaries and citation of the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital in the Commentaries on the articles of the United Nations Model Double Taxation Convention between Developed and Developing Countries

68. Lise-Lott Kana and Mustapha Kharbouch presented document E/C.18/2007/CRP.8/Rev.1, noting that they had understood the mandate of their group (to coordinate possible changes to the Commentaries to the United Nations Model Convention) not to be a wide one. In referring to the levels of support for particular proposals, they noted some issues that had been raised with regard to them, including some linguistic and other issues, such as consistency of terminology. One concern was whether the references to the views of "developing" or "developed" countries should be retained in the older Commentaries or used in the new Commentaries.

69. **It was decided that the status of the group should be upgraded to that of a working group. As described in paragraph 31 above, it was decided that relevant country positions should be included in the Manual rather than in the Commentaries themselves. It was also decided that Adrián Groppoli (observer for Argentina) would be added as a member of the working group.**

70. **Based on the discussion of document E/C.18/2007/CRP.13, it was decided that lengthy quotations from the OECD Model should make appropriate attribution, and that such quotations should follow the proposed style of indented paragraphs in a smaller font with italicized paragraph numbers and no quotation marks. It was also decided that proposed article 27 of the United Nations Model should be amended in the same fashion, as indicated in annex 3 of the paper, so that it could be made publicly available in its final form.**

H. Treatment of Islamic financial instruments

71. It was noted that there were a variety of Islamic financial arrangements, and that the tax consequences of any given arrangement might depend on the specific facts of the case as well as the tax laws of the country concerned. Therefore, it was very difficult to draw general conclusions regarding the taxation of Islamic financial instruments; however, in general, it was necessary to distinguish between two approaches in this respect: a legal approach, which looked at the form of (Islamic financial) transactions, and an economic approach, which looked at the substance thereof.

72. Most countries where Islamic finance was practised seemed to have adopted the economic approach so as to ensure equal treatment for tax purposes of Islamic instruments as compared with their conventional counterparts. Even countries that generally followed the legal approach to taxation (for example, the United Kingdom of Great Britain and Northern Ireland) had enacted special legislation to treat Islamic instruments according to their substance, thereby following the economic approach in that area. The adoption of the legal approach would lead to "anomalies" in the tax treatment of Islamic instruments which would adversely affect their development. The economic approach suggested the application of article 11 of the Model Double Taxation Convention to Islamic financial instruments.

73. **It was decided that the subcommittee would prepare, for the Commentary, a short general description in relation to other arrangements that would cover returns from Islamic financial instruments, as well as a more extensive version for the Manual.**

I. Report of the Expert Group Meeting on Tax Aspects of Domestic Resource Mobilization and Doha Financing for Development Follow-up Conference issues

74. The Secretariat was also invited to present for consideration the report of the Expert Group Meeting on Tax Aspects of Domestic Resource Mobilization (E/C.18/2007/CRP.14). It was noted that it might be useful for the Committee to consider broad recommendations made in the report regarding carrying out work in certain areas without unnecessarily duplicating other work in those areas, and that this would assist developing countries and economies in transition.

75. The comment was made that the Committee could not be overly ambitious in its work, in view of its limited resources, but that it would need to prioritize the work on the basis of the needs of developing countries.

76. The Secretariat also noted the developments in respect of the lead-up to the Doha Financing for Development Follow-up Conference. It was noted that there was considerable interest in the taxation aspects of development and that there were high expectations regarding what the Committee could achieve.

77. **The Committee was asked to consider how it could best input into the process of preparing for the Doha Follow-up Conference and it was agreed that such consideration would be under an item to be included in the agenda for the Committee's next annual session.**

Chapter IV

Dates and agenda for the fourth session of the Committee

78. The Committee decided that the draft agenda for the fourth session would be as follows:

1. **Improper use of treaties.**
2. **Definition of permanent establishment.**
3. **Taxation of development projects.**
4. **Exchange of information, including the proposed code of conduct.**
5. **Revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries.**
6. **Dispute resolution.**
7. **General issues in the review of Commentaries.**
8. **Treatment of Islamic financial instruments.**
9. **Doha review conference on financing for development.**
10. **Dates and agenda for the fifth session.**
11. **Adoption of the report.**

79. The Committee decided to hold its fourth session from 20 to 24 October 2008.

Chapter V

Adoption of the report of the Committee on its third session, to be submitted to the Economic and Social Council

80. The Committee approved and adopted the present report for submission to the Economic and Social Council.

81. In the course of its current session, the Committee reiterated its request, contained in its report on its second session,[4] for additional resources needed for face-to-face subcommittee and working group meetings with special reference to ensuring the full and effective participation of members of those subcommittees from developing countries and countries with economies in transition. The Committee also underlined the importance of additional resources for organizing capacity-building workshops in developing countries and countries with economies in transition. In this connection, it was noted that both Viet Nam and Pakistan had restated their willingness to host training workshops.

[4] *Official Records of the Economic and Social Council, 2006, Supplement No. 45* (E/2006/45).

Chapter VI
Conclusions and policy recommendations

82. The following includes the conclusions for each agenda item, as reflected in the body of the present report:

Improper use of treaties

83. The subcommittee was requested to substantially complete the work on the paper by the fourth session of the Committee, taking into account such issues as the application of the concept of beneficial ownership to other articles of the Model Convention and the redrafting of the Commentary to reflect different approaches taken by States to the use of the terms "the main purpose" and "a main purpose". It was agreed that the subcommittee would adopt the second option relating to gains, under the note to paragraph 101 of the paper, rather than the first option.

Definition of permanent establishment

84. It was agreed that the paper on an updated commentary to the existing article 5 had been finalized, taking into account the need to make a small number of minor changes to the draft, as noted in the discussions. The subcommittee was mandated to continue its work on the updating of document E/C.18/2007/CRP.4 regarding a possible new article 5 and Commentary on that article in time for consideration at the Committee's fourth annual session, taking into account the issues raised in the discussions.

Taxation of development projects

85. The staff of the International Tax Dialogue Steering Group were invited to continue their work, including discussing the draft guidelines in a joint meeting or meetings of donors and tax experts. Harry Msamire Kitillya and Habiba Louati were appointed by the Committee to liaise with the staff of the Steering Group on this issue and monitor the work for the Committee.

Exchange of information including the United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance

86. The Committee decided that Miguel Ferre Navarrete should join the subcommittee and assume the role of Coordinator. The subcommittee was asked to continue its work with a view to coordinating the views expressed in the discussions and finalizing the work as soon as possible.

87. The idea of the proposed United Nations Code of Conduct on Cooperation in Combating International Tax Evasion was widely supported, although it was noted that references addressing the possible political and economic isolation of countries should be removed. It was suggested that the title of the document

should be amended to refer to tax evasion only and that the relationship between normal tax planning and abusive practices should be explained. It was decided that the work should be fully integrated into the work of the subcommittee on Exchange of Information, with a view to making available a revised report and Code of Conduct as soon as possible.

Revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries

88. It was agreed that the subcommittee would continue its work on revising the Manual. It was also decided that Renee Villagra Cayamana (observer for Peru), Salah Gueydi (observer for Qatar) and Robin Oliver (observer for New Zealand) would be added as members of the working group.

Dispute resolution

89. The subcommittee was asked to continue its work in light of the views expressed in the discussions, particularly in relation to ways of improving the mutual agreement procedure. It was agreed that Rowena Bethel would join the subcommittee.

Revision of Commentaries and citation of the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital in the Commentaries on the articles of the United Nations Model Double Taxation Convention between Developed and Developing Countries

90. It was decided that the status of the group should be upgraded to that of a working group. As described in paragraph 31 above, it was decided that relevant country positions should be included in the Manual rather than in the Commentaries themselves. It was also decided that Adrián Groppoli (observer for Argentina) would be added as a member of the working group.

91. Based on the discussion of document E/C.18/2007/CRP.13, it was decided that lengthy quotations from the OECD Model should make appropriate attribution, and that such quotations should follow the proposed style of indented paragraphs in a smaller font with italicized paragraph numbers and no quotation marks. It was also decided that proposed article 27 of the United Nations Model should be amended in the same fashion, as indicated in annex 3 of the paper, so that it could be made publicly available in its final form.

Treatment of Islamic financial instruments

92. It was decided that the subcommittee would prepare, for the Commentary, a short general description in relation to other arrangements that would cover returns from Islamic financial instruments, as well as a more extensive version for the Manual.

Report of the Expert Group Meeting on Tax Aspects of Domestic Resource Mobilization and Doha Financing for Development Follow-up Conference issues

93. The Committee was asked to consider how it could best input into the process of preparing for the Doha Follow-up Conference and it was agreed that such consideration would be under an item to be included in the agenda for the Committee's next annual session.

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